

**REVIEW OF 1999 FILING SEASON
READINESS TO PROCESS BUSINESS
MASTER FILE RETURNS WITH
TAX LAW CHANGES**

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**Review of 1999 Filing Season Readiness to Process
Business Master File Returns With Tax Law Changes**

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Executive Summary

The Service prepares for the filing season by developing a Filing Season Readiness Action Plan and by completing the action items in the plan. Legislative Affairs coordinates the IRS-wide implementation of legislation changes to the Internal Revenue Code. This plan addresses actions necessary to complete the publication of guidance for the public, changes to forms and publications, and changes to processing or compliance procedures. The objective for this review was to determine whether the Service's process in implementing tax law changes for the 1999 filing season was effective to accurately process returns to the Business Master File (BMF) and to provide taxpayers with sufficient information to comply with the new tax laws.

Results

Our review focused on Taxpayer Relief Act 1997 (TRA) and IRS Restructuring and Reform Act 1998 (RRA) tax law changes that were highly significant in terms of revenue, impact on taxpayers, sensitivity, or complexity for BMF returns. We identified and reviewed the readiness process for seven key BMF tax law changes that affect the 1999 filing season.

During the BMF readiness process for the 1999 filing season the Service developed an action plan and conducted steering committee meetings to ensure the responsible functions completed the action items. The readiness process reduced the risk of having an unsuccessful BMF filing season by:

- Identifying tax law changes affecting BMF processing and the action needed to implement the changes into the processing system.
- Ensuring that tax forms and instructions were adequately revised to help taxpayers in complying with the new tax laws.
- Ensuring that Requests for Information Services (RIS) to change computer programs were accurate and complete.

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Objectives and Scope

Internal Audit reviewed the Service's process for implementing Business Master File tax law changes.

The objective of this review was to determine whether the Service's process in implementing tax law changes for the 1999 filing season was effective to:

- Ensure that Requests for Information Services (RISs) contained necessary tax law changes to accurately process returns to the Business Master File (BMF) accounts.
- Provide the taxpayers with revised forms and instructions to comply with the new laws.
- Ensure sufficient information was being gathered to monitor compliance with key tax law changes.

We reviewed the readiness process for seven key BMF tax law changes that affect the 1999 filing season.

The review focused on the Taxpayer Relief Act 1997 (TRA) and IRS Restructuring and Reform Act 1998 (RRA) tax law changes that were highly significant in terms of revenue, impact on taxpayers, sensitivity, or complexity for BMF returns. Specifically, we reviewed controls and procedures and made tests for seven key tax law provisions to determine if:

- The Service's implementation plan identified all the significant new BMF tax laws and the major changes needed for the 1999 filing season to effectively implement them.
- The tax forms and instructions contained sufficient and accurate information to assist taxpayers in filing correct returns and to request necessary information for compliance reviews.
- The RISs completely and accurately detailed the computer program changes needed for the new tax laws so returns could be correctly processed and sufficient tax return information would be available for compliance reviews.

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This review was one of the audits conducted to support the Internal Audit emphasis area of assessing the overall effectiveness of tax administration for the 1999 filing season. Other audits covered tax law changes for individual returns and the adequacy of computer program changes for both individual and business tax returns.

We conducted this review in accordance with generally accepted government auditing standards. A detailed scope of the review is included in Attachment I.

Background

IRS processes over 10 million BMF returns yearly such as corporation, partnership, estate, and gift tax returns. New legislation, the TRA of 1997 and IRS RRA of 1998, will affect the processing of many of the returns. IRS must adequately plan for processing these returns to ensure that taxpayers have sufficient information to comply with tax law changes, the returns are processed accurately to BMF accounts, and refunds are issued timely.

IRS management prepares an action plan as a control to ensure action items are completed.

Legislative Affairs coordinates the IRS-wide implementation of tax law changes. This process includes the identification of responsible functions, actions to be completed, and target completion dates. Actions include the publication of guidance for the public, changes to forms and publications, and changes to processing or compliance procedures. Implementation plans are developed to serve several functions. First, they document agreements by IRS functions as to what is needed to implement an act and who will do it. Second, they inform executives and employees of their implementation responsibilities. Third, they provide a means of monitoring successful completion.

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Results

We analyzed the Taxpayer Relief Act and the IRS Restructuring and Reform Act and identified seven key tax law provisions for corporation, partnership, estate, and gift tax returns that were effective for the 1999 filing season. Our review showed:

- The Service's readiness process for the 1999 filing season was adequate in identifying the key tax law provisions and the actions needed to implement them into the Business Master File (BMF) processing system.
- Request for Information Services (RISs) contained the necessary information to change computer programs for the key tax law provisions.
- Tax Forms and instructions contained appropriate changes for the key tax law provisions to help taxpayers in filing correct returns.

The implementation plan identified the key BMF tax provisions and actions needed.

The Service's readiness process was adequate in identifying BMF tax provisions affecting the 1999 filing season.

Through a review of the Taxpayer Relief Act (TRA) of 1997 and the IRS Restructuring and Reform Act (RRA) of 1998, we identified seven key legislative Business Master File (BMF) changes affecting the 1999 Filing Season. Identification of these seven key BMF provisions was based upon significant increase or decrease in revenue, number of taxpayers affected, sensitivity, or complexity of the issue that could result in negative publicity if not handled properly.

The seven key BMF provisions we identified and reviewed were:

1. Unified Estate and Gift Tax Credit Adjustments.
 - Increased estate and gift tax credit on a phased-in basis beginning in 1998 so that the maximum value of estates exempt from tax would rise to

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\$625,000 in 1998, \$650,000 in 1999 and eventually reaching \$1,000,000 in 2006.

2. Qualified Family-Owned Business Deduction.
 - Permitted executors in certain situations to elect special estate tax treatment for qualified “family-owned business interests.” In general, the tax law provision will allow a deduction of up to \$675,000 of value in qualified family-owned business interests from a decedent’s taxable estate.
3. Extensions of Time to Pay for Closely-Held Businesses.
 - Reduced the special four percent interest rate on the deferred tax to two percent in certain instances.
 - Additional estate tax deferred under § 6166 to be computed at 45 percent of the normal interest rate for deficiencies.
 - Provided that no estate tax deduction was to be allowed for the interest paid on the deferred estate tax.
4. Net Operating Loss Carryback and Carryforward Periods.
 - In applicable situations, the carryback period was lowered from three years to two years and the carryforward was extended from 15 years to 20 years.
5. Incentives for Employing Long-Term Family Assistance Recipients.
 - Provided a new, temporary welfare-to-work credit, which allowed employers a credit against tax on eligible wages paid to qualified long-term family assistance recipients during the first two years of employment.
6. Simplified Flow-Through for Electing Large Partnerships.

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- Provided a simpler method of reporting taxes for electing large partnership and its partners effective for tax years beginning after December 31, 1997.
7. Exemption from Alternative Minimum Tax (AMT) for Small Corporations.
- Provided an exemption for qualified small business corporations from the AMT for taxable years beginning after 1997.

Our review showed that Legislative Affairs sufficiently identified the key BMF tax provisions and actions needed to implement the key provisions.

Requests for Information Services to change programs were complete and accurate.

Changes in the tax laws may require revisions to computer programs. The designated affected area initiates computer programming revisions through the preparation of a Request for Information Services (RIS). Quality Assurance ensures that all computer programs follow standards and meet the needs of the system's end customers.

RISs relating to the seven key law changes contained the necessary information needed to implement the legislative provisions.

We reviewed RISs relating to the seven key tax law changes to ensure they contained the necessary information to accurately implement the key legislative provisions. Our analysis indicated that the programming changes requested were adequate. Our review did not, however, include an analysis of the effectiveness of the computer programming by Information Systems (IS). Another audit will focus on the effectiveness of the Service's systems for assigning, controlling, and completing RISs to ensure complete and accurate programming, and for providing Product Assurance by testing programs.

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Tax forms and instructions were adequately changed to assist taxpayers in filing returns with new tax provisions.

Tax forms and instructions relating to the seven key BMF provisions contained appropriate changes.

The Legislative Affairs Implementation Plan listed forms, instructions, and publications affected by each tax law change. The plan indicated the functions responsible for making necessary changes and the date the change was due to be completed.

We reviewed the applicable schedules, forms, and publications that related to the seven key BMF provisions to ensure they were timely and accurately prepared, easily understood, and courteous. Our review showed that the appropriate changes were timely made.

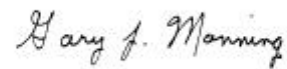
Sufficient tax information will be maintained to identify compliance issues.

New tax laws may affect the type of information needed by compliance officials to ensure taxpayers are complying with the new tax provisions. To determine if the Service was capturing the necessary data for the seven BMF provisions for compliance purposes, we reviewed the additional information requested on returns, RISs, and held discussions with compliance personnel to solicit their concerns. We found that returns and computer records contained adequate information to meet compliance organizational needs. In addition, compliance personnel felt that sufficient information would be available to ensure taxpayers were complying with the new tax provisions.

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Conclusion

The readiness process reduced the risk of having an unsuccessful BMF filing season. IRS officials developed an extensive action plan and through executive steering committee meetings ensured the significant action items were timely completed by the IRS processing functions.



Gary J. Manning
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Attachment I

Detailed Audit Objectives and Scope of Review

The objective of this review was to determine whether the Service's readiness process was effective in implementing tax law changes for Business Master File (BMF) returns. The review focused on the Taxpayer Relief Act (TRA 1997) and the IRS Restructuring and Reform Act (RRA 1998) tax law changes that were highly significant in terms of revenue, impact on taxpayers, sensitivity, or complexity.

Objective 1: Identified and evaluated key internal controls to ensure the Service properly implemented significant legislative changes affecting BMF taxpayers for the 1999 filing season and that the Service would be able to properly process BMF tax returns.

Objective 2: Determined that legislative provisions were properly considered for the 1999 Filing Season.

- Reviewed the laws enacted in August 1997, Taxpayer Relief Act, and July 1998, IRS Restructuring and Reform Act, and identified seven significant tax law changes that would impact the 1999 filing season and determined that necessary steps were taken to effectively implement them.
- Reviewed the Legislative Affairs Early Action Plans to determine if the plan identified major changes needed for computer programs, tax forms and instructions, publications, and IRM procedures.

Objective 3: Determined that Requests for Information Services (RISs) identified during the Phase I portion of the Readiness Audit contained the necessary information to accurately implement the key legislative provisions relating to the seven identified significant tax law changes.

- Reviewed RISs as they relate to the seven key BMF provisions and determined that they contained adequate and accurate information to properly prepare required programs.

Objective 4: Determined that tax forms, instructions, and publications were timely and accurately prepared, and used plain, clear, and courteous language that would help facilitate taxpayer compliance with the seven key BMF legislative provision areas.

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- Reviewed BMF series of forms (such as the Form 1065B, 706, 706NA, and 709) and relevant schedules to ensure that applicable forms, schedules, etc:
 - complied with the legislative provisions of the new laws,
 - were clearly written and easily understood,
 - had been changed to inform taxpayers to make checks payable to the United States Treasury, and
 - contained necessary information to be gathered for up-front and/or downstream compliance efforts.

Objective 5: Determined that Compliance organizational information requirements were adequately considered in the planning for the 1999 Filing Season, including appropriate line items on returns and information gathering/reporting documentation needs.

- Evaluated the adequacy of maintaining sufficient information for compliance purposes by reviewing the additional information requested on the returns and additional requirements in the RISs for capturing the information in computer files.
- Held discussions with local compliance managers and solicited their concerns regarding compliance with the seven key BMF legislative provisions and their information needs to ensure compliance with the key tax provisions.